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BY THE COMPTROLLER GENERAL

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Report To The Congress

OF THE UNITED STATES

Federal Examinations Of Financial Institutions: Issues That Need To Be Resolved

Five Federal agencies are responsible for supervising 41,000 privately owned financial institutions. Onsite examinations are the principal means used by these agencies to carry out their supervisory responsibility. The primary objectives of examinations are to evaluate the institutions' soundness and to determine whether applicable laws and regulations are complied with.

While these objectives are similar, the concepts, approaches, scope, and frequency differ from agency to agency. The Congress established the Federal Financial Institutions Examination Council to promote uniformity in the examination and supervision of financial institutions. This report identifies several areas in the examination process which are not uniform and need attention.

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COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

FEDERAL EXAMINATIONS OF FINANCIAL INSTITUTIONS: ISSUES THAT NEED TO BE RESOLVED

D I G E S T

Five Federal agencies 1/are responsible for supervising 41,000 privately owned financial institutions. Using onsite examinations as the principal means, the agencies monitor the activities of the institutions and identify problems that require corrective actions. GAO surveyed the practices followed by the agencies in examining the commercial activities of financial institutions and found that:

--There are differing practices among and even within the agencies regarding acceptance of examinations made by State regulatory agencies in lieu of their own. (See p. 10.)

--The agencies have different criteria for scheduling examinations which generally do not adequately weigh the risks of institutional failures or problems against the cost and burden of examinations with the result that some institutions may be examined more--or less--frequently than necessary. (See p. 15.)

--The use of timesaving techniques varies among the agencies. (See p. 19.)

--The agencies have different policies regarding reliance on institutions' internal review groups, with the result that some duplicate work that is competently performed by these groups. (See p. 21.)

1/Office of the Comptroller of the Currency (OCC), Federal Reserve System (FRS), Federal Deposit Insurance Corporation (FDIC), Federal Home Loan Bank Board (FHLBB), National Credit Union Administration (NCUA).

--The amount of data included in the examination reports varied among the agencies and some data included in the reports did not appear to be useful to either the regulator or the financial institution. (See p. 24.)

--The agencies place varying emphasis on examining management activities in the institutions even though there appears to be little difference in examination objectives among the five Federal agencies. (See p. 33.)

--The agencies have different policies regarding specific guidelines for conducting and documenting examinations. (See p. 41.)

THE BURDEN OF EXAMINATIONS CAN BE REDUCED

Examinations of financial institutions--whether by a Federal or a State agency--are costly and disruptive to the operations of the institution. However, the Federal Financial Institutions Examination Council has opportunities to make examinations less burdensome. The functions of the Council are to establish uniform principles and standards and report forms for Federal examinations of financial institutions, to conduct schools for examiners, and to make recommendations for uniformity in other supervisory matters. The Council has established a subcommittee to study examination philosophies, concepts, and procedures and will be considering various proposals designed to promote consistency in the examination process. (See pp. 6 and 7.)

After studying the various approaches to examinations of financial institutions in use by the five Federal regulatory agencies, the Council would be in an excellent position to establish optimal examination principles and standards. The Council has an opportunity to reduce the cost and burden of examinations by establishing principles and standards which require the Federal agencies to

--rely more extensively on examinations performed adequately by State agencies,

--schedule examinations, to the extent possible, on the basis of a perceived need to examine rather than to comply with a static time frame,

--rely more on limited scope or modified examinations,

--rely more on work adequately conducted by institutions' internal review systems, and

--limit the information now included in the report of examination to that required by institutions and regulators.

SUPERVISORY ROLE NEEDS TO BE CLEARLY DEFINED

The Council also needs to consider the Federal supervisory role in overseeing institutions' management. Emphasis differs according to each agency's degree of concern about the time required to complete the examinations and about the likelihood that examination of management will infringe on the institutions' legitimate management decision-making process.

It is not clear from our review of the agencies' legislative mandates and their policies and procedures to what extent the examination process should properly influence the institutions' management decisions and activities or when such influence infringes on the prerogatives of management. Before the Council establishes uniform principles and standards, it should define the extent and nature of an appropriate Federal supervisory role in this area, especially with regard to institutions that may have management problems but are financially sound and in compliance with laws and regulations.

EXAMINATIONS NEED TO BE MORE STRUCTURED

Some agencies, by allowing their examiners considerably more discretion than do others in conducting examinations, have little assurance that examinations are conducted uniformly in all critical areas of the institutions' activities. Additionally, some agencies do not require docu-

mentation of examination procedures followed, tests performed, and information obtained. In establishing principles and standards for the Federal examination of financial institutions, the Council needs to establish standards to assure that examiners follow appropriate examination procedures and document their work.

RECOMMENDATIONS

GAO recommends that the Federal Financial Institutions Examination Council:

--Develop a Government-wide policy for assessing, monitoring, and accepting State examinations in lieu of Federal examinations when the State's work is considered adequate. (See pp. 25 and 26.)

--Develop a uniform system for scheduling examinations which is based on the need to examine an institution rather than on a fixed time frame. (See p. 26.)

--Develop examination standards which limit the amount of detailed work performed during a routine examination unless potential problems are detected. (See p. 26.)

--Develop examination principles which require Federal examiners to rely on functions adequately performed by others such as internal and external audit and internal loan review departments. (See p. 26.)

--Develop uniform standards for reporting the results of examinations which limit the amount of detailed data to that which is necessary for effective supervision. (See p. 26.)

--Define the supervisory role of the Federal agencies and, in particular, the extent to which they should attempt to influence the institutions in their management processes. (See p. 46.)

--Prescribe principles and standards which include the requirement that Federal

regulators develop structured examination procedures that clearly identify (1) examination objectives, (2) examination tasks required to achieve the objectives, and (3) documentation required to fully support report comments, conclusions, and recommendations. (See p. 47.)

AGENCY COMMENTS

The Federal Financial Institutions Examination Council generally agreed with the issues GAO identified and with GAO's assessment that the Council should address these issues in developing uniform principles and standards. The Council, however, did question whether it was appropriate for it to

--assess the acceptability of State examinations of financial institutions in lieu of Federal examinations and

--establish a Government-wide policy which requires Federal regulators to accept examinations that are competently conducted by State examiners.

While the Council has directed one of its task forces to explore ways in which the Federal regulators can place greater reliance on State examinations, it believes that any final decisions regarding the acceptability of State examinations in lieu of Federal examinations should be made by the Federal regulators.

Irrespective of whether final decisions on accepting State examinations are made by the agencies or the Council, GAO favors a strong role by the Council to avoid duplicative and possible inconsistent consideration and acceptance of State examination programs by the Federal regulators.

Federal regulators were in general agreement with GAO's proposal to increase reliance on limited scope examinations and on functions

adequately performed by internal and external audit and loan review departments.

The regulators also agreed with GAO's proposal to limit the amount of detailed data shown in examination reports even though some comments reflected a belief that they were already following some of these proposals. But, to varying extents, Federal regulators took exception with GAO's proposal to increase reliance on State agencies and to schedule examinations on the basis of perceived need rather than static time frames.

Federal regulators, with the exception of the Federal Deposit Insurance Corporation, did not basically disagree with the need for the Council to more clearly define how active Federal regulators should be in influencing management decisions regarding the operations of financial institutions. (See pp. 27 and 47 and app. I through VI for full text of all comments received.)

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ABBREVIATIONS

FDIC	Federal Deposit Insurance Corporation
FHLBB	Federal Home Loan Bank Board
FRS	Federal Reserve System
GAO	General Accounting Office
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency